

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2011030204602**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Jonathan Harold Frede, Respondent
CRD No. 830352

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, I submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against me alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A.** I hereby accept and consent, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Frede entered the securities industry in 1975 and became registered as a Series 7 General Securities Representative and a Series 24 General Securities Principal with a FINRA regulated broker-dealer in 1976 and 1987 respectively. During the period from approximately April 1991 through January 2008, Frede was successively registered with six additional FINRA regulated broker-dealers. In February 2005, Frede became registered with Murphy & Durieu, L.P. ("Murphy & Durieu" or the "Firm"), a FINRA regulated broker-dealer, as a Municipal Securities Principal. In March 2005, he became registered with the Firm as a General Securities Representative, a General Securities Principal, a Registered Options Principal, a General Securities Sales Supervisor, and a Municipal Securities Principal. In 2005, Frede became the Firm's Chief Compliance Officer ("CCO") and Anti-Money Laundering Compliance Officer ("AMLCO").

On March 5, 2013, the Firm filed a Uniform Termination Notice for Securities Industry Registration ("Form U5") on Frede's behalf reporting that on February 18, 2013, Frede voluntarily terminated his association with the Firm. Although Frede has not been associated with another FINRA-regulated entity since March 5, 2013, he remains subject to FINRA's jurisdiction until March 4, 2015, pursuant to Article V, Section 4 of FINRA's By-Laws.

RELEVANT DISCIPLINARY HISTORY

Frede has no previous disciplinary history in the securities industry.

OVERVIEW

During the period from January 1, 2011 through June 29, 2012 (the "Relevant Period"), Frede was the designated supervisor responsible for establishing and maintaining a supervisory system and written supervisory procedures ("WSPs") to ensure that the Firm did not facilitate the unregistered distribution of securities in contravention of Section 5 of the Securities Act of 1933 ("Section 5"). Frede was also the AMLCO delegated the responsibility to establish and implement Anti-Money Laundering ("AML") policies and procedures reasonably designed to cause the detection and reporting of suspicious transactions. Frede failed to reasonably carry out any of these responsibilities.

Frede did not establish a supervisory system or develop WSPs reasonably designed to ensure compliance with Section 5. Instead, the Firm's supervisory system and WSPs failed to adequately address customer trading in Delivery Versus Payment/Receive Versus Payment Accounts ("DVP/RVP accounts"), despite the fact that customer liquidations of low-priced securities were frequently effected in such accounts.

Similarly, Frede did not design AML policies and procedures that were adequately tailored to the Firm's business model, in light of customer liquidations of low priced securities through DVP/RVP accounts. The Firm's AML policies and procedures did not describe in sufficient detail how the Firm would monitor for potential suspicious activity, or how the Firm would investigate the activity after identifying AML "red flags." The Firm relied on exception reports that did not capture suspicious trading activity in DVP/RVP accounts.

Frede also failed to adequately implement the AML procedures that were in effect at the Firm. Frede failed detect and adequately investigate potentially suspicious trading activity in DVP/RVP accounts, including that of a correspondent account for a foreign financial institution ("FFI"), which engaged in the large-scale liquidation of penny stocks under circumstances that should have triggered additional scrutiny. Frede also failed to conduct adequate due diligence on that account.

FACTS AND VIOLATIVE CONDUCT

1. Frede Failed to Establish and Maintain a Supervisory System and WSPs Reasonably Designed to Prevent Distributions of Unregistered Securities

Frede was designated the supervisory responsibility for establishing and maintaining the Firm's supervisory system and its WSPs.

Section 5 prohibits any person, directly or indirectly, from selling a security in interstate commerce unless a registration statement is in effect as to the offer and sale of that security, or there is an applicable exemption from the registration requirements. A violation of Section 5 constitutes a violation of FINRA Rule 2010, which requires that "in

the conduct of its business," a FINRA member, "observe high standards of commercial honor and just and equitable principles of trade."

In January 2009, FINRA reminded members in Regulatory Notice 09-05 that firms are required to have procedures reasonably designed to avoid becoming participants in the potential unregistered distribution of securities, and that they could not rely solely on others, such as clearing firms, transfer agents, or issuers' counsel, to fulfill these obligations. Moreover, before selling unregistered securities, brokers have a duty under Section 5 to conduct a searching inquiry to determine whether or not the securities are registered or exempt from registration.

In June of 2009, as a result of a previous FINRA examination of the Firm, the Firm prohibited sales of penny stocks from customer accounts if the customer's shares were deposited as physical certificates or through Deposit and Withdrawal at Custodian ("DWAC") electronic transfers.¹ The Firm's customers then began establishing more DVP/RVP accounts, and in fact customer trades in low-priced securities were frequently effected through DVP/RVP accounts after June 2009.²

However, the Firm's supervisory system and procedures were not adequately designed to address trading in low-priced securities through DVP/RVP accounts. Frede was responsible for updating the Firm's supervisory system and procedures during the Relevant Period, but failed to update them even though he knew that many low-priced security liquidations were effected through DVP/RVP accounts.

As a result, the Firm's supervisory system was inadequate in several ways. Primary supervision for re-sales of restricted securities was based on a supervisor's review of Share Deposit Certification Forms received from the customers. Since the Firm's DVP/RVP business did not involve the deposit of shares of stock into customer accounts, this review did not capture trading in DVP/RVP accounts. In addition, the Firm generated exception reports to detect patterns or practices of unregistered re-sales of securities, but the exception reports did not capture suspicious trading activity in DVP/RVP accounts. The Firm's supervisory system also included trade blotter reviews, which captured activity in DVP/RVP accounts, but these reviews were intermittent and inadequate to identify red flags of potentially unregistered distributions. In light of the frequent liquidation of low-priced securities through customers' DVP/RVP accounts, the Firm's supervisory system was not adequately tailored to the needs of its business.

In addition, the Firm's WSPs were inadequate in that they failed to address trading of low-priced securities through DVP/RVP accounts. Although the WSPs recited certain examples of red flags indicative of possible Section 5 violations, the WSPs provided no guidance to Firm personnel as to whether these red flags were applicable to activity in DVP/RVP accounts. Certain Firm personnel believed that it was unnecessary to determine

¹ DWAC is a method of transferring securities using electronic bookkeeping entries.

² NASD Rule 2340(d)(6) defines a DVP/RVP account as "an arrangement whereby payment for securities purchased is made to the selling customer's agent and/or delivery of securities sold is made to the buying customer's agent in exchange for payment at time of settlement, usually in the form of cash."

whether or not shares of penny stocks liquidated through a DVP/RVP account were legally permitted, partly based upon the absence of any guidance on this topic in the WSPs.

NASD Rule 3010(a) requires that FINRA-regulated firms “establish and maintain a system to supervise activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules.”

NASD Rule 3010(b)(1) requires that “[e]ach member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD.”

By failing to establish and maintain a supervisory system, including written procedures, that was reasonably designed to ensure compliance with Section 5, Frede violated NASD Rules 3010(a) and (b), and FINRA Rule 2010.

2. Frede Failed to Establish AML Procedures Reasonably Designed to Detect, Investigate and Report Suspicious Activity

FINRA Rule 3310 requires that FINRA firms develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act (“BSA”) and the implementing regulations promulgated thereunder. FINRA Rule 3310(a) requires that FINRA members establish and implement policies and procedures “that can be reasonably expected to detect and cause the reporting of “suspicious activity and transactions.” On July 2, 2002, the Department of Treasury (“Treasury”) issued regulation 31 CFR §103.19(a)(1),³ requiring that broker-dealers report suspicious transactions. Under this regulation, all broker-dealers must file with Financial Crimes Enforcement Network (FinCEN) a suspicious activity report (“SAR”) to report a transaction if it involves assets of at least \$5,000, and the broker-dealer knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions), among other things: (1) involves funds derived from illegal activity, or activity that is designed to evade any federal law or regulation; and/or (2) has no business purpose or apparent lawful purpose, or is not the sort of activity in which the particular customer would typically engage. The US Treasury has also instructed that broker-dealers conduct a further inquiry of certain transactions that may be indicative of potentially suspicious activity (*i.e.* “red flags”). Notice to Members 02-21 emphasizes each firm’s duty to detect “red flags” and, if detected, “perform additional due diligence before proceeding with the transaction.”

The Firm’s AML procedures designated to Frede the responsibility to develop policies, procedures, and internal controls reasonably designed to achieve compliance with AML

³ Effective January 3, 2011, Treasury issued new regulation 31 CFR 1023.320, amending the BSA, regarding the confidentiality of suspicious activity reports. The new rule clarified, modified, and revised the requirements that a broker-dealer make suspicious activity reports and supporting documentation available to any self-regulatory organization that examines the broker-dealer for compliance with the rule, upon the request of the Securities and Exchange Commission.

rules and regulations (the "AML Procedures"). However, the Firm's AML Procedures did not reasonably address the Firm's customers' liquidation of low-priced securities through DVP/RVP accounts.

The Firm's AML Procedures did not specify how the Firm would monitor trade activity, how accounts would be selected for monitoring, or the type of review that would be conducted. The written procedures did not set forth how the Firm would investigate patterns of activity or how it would conduct trade reviews to detect and investigate possible illegal re-sales of restricted securities, market manipulation, fraud, or insider trading.

Based on the foregoing, Frede failed to establish reasonably designed policies and procedures to cause the detection and reporting of suspicious transactions in violation of FINRA Rules 3310(a) and 2010.

3. Frede Did Not Adequately Implement the AML Procedures

Frede was responsible for implementing the Firm's AML Procedures but failed to adequately do so. Frede was responsible for monitoring the Firm's activity to reasonably detect and prevent money laundering activities, but did not reasonably monitor the Firm's activity as required. Frede reviewed monthly exception reports, but the exception reports did not capture suspicious trading activity effected through DVP/RVP accounts. Frede knew that customers frequently liquidated low-priced securities through DVP/RVP accounts and knew that this activity was not adequately reflected in the exception reports. Although Frede intermittently reviewed daily trade blotters, which captured trading in DVP/RVP accounts, his review was not reasonably designed to identify potentially suspicious trading patterns. Frede also failed to evidence or document any of his reviews.

Frede was also responsible for conducting due diligence for correspondent accounts. Federal regulations promulgated pursuant to the Bank Secrecy Act, 31 U.S.C. 5311, *et seq.*, require broker-dealers to establish due diligence programs for "correspondent accounts for foreign financial institutions." The term "correspondent account" is defined by 31 CFR Section 1010.605(c)(i) as "an account established for a foreign financial institution to receive deposits from, or to make payments or other disbursements on behalf of, the foreign financial institution, or to handle other financial transactions related to such foreign financial institution." Under 31 CFR Section 1010.610(a), a broker-dealer's due diligence program must include "appropriate, specific, risk-based, and, where necessary, enhanced policies, procedures and controls that are reasonably designed to enable the [broker-dealer] to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account established, maintained, administered, or managed by such [broker-dealer] in the United States for a foreign financial institution."

The Firm's AML Procedures contained a section entitled, "Due Diligence For Correspondent Accounts for Foreign Financial Institutions," that set forth minimum due diligence requirements applicable to correspondent accounts for FFIs. They required Frede to conduct an assessment of the money laundering risk posed by a correspondent account for an FFI based on consideration of a list of potential risk factors enumerated in 31 CFR

1010.610(a). These risk factors include:

- The nature of the foreign financial institution's business and the markets it serves;
- The type, purpose, and anticipated activity of the correspondent account;
- The nature and duration of [the Firm's] relationship with the foreign financial institution;
- The AML and supervisory regime in which the foreign financial institution is chartered or licensed;
- Information known or reasonably available to [the Firm] about the foreign financial institution's AML record.

When conducting his due diligence, Frede failed to adequately perform an assessment of potential risk factors for certain FFIs as required by the AML Procedures and the regulations promulgated under the Bank Secrecy Act.

For example, in December 2010, Frede approved an account for RC, a correspondent account for an FFI. The new account documents for the RC Account identified RC as a Swiss broker-dealer and investment advisor. Among other things, Frede failed to take reasonable steps to understand the nature of RC's business, the markets it served, and the purpose of its trading activity.

As described above, Frede also failed to reasonably monitor trading for potential suspicious activity. As a result of Frede's failure to adequately implement the AML Procedures, he failed to detect significant red flags that could indicate suspicious activity. During the Relevant Period, the RC Account sold large blocks of two low-priced stocks, ABC and DEF, under circumstances that should have triggered additional scrutiny, as described below.

a. Red Flags relating to trading in ABC by the RC Account

On April 29, 2011, the RC Account entered an order to sell 150,000,000 common shares of ABC and sold 67,878,000 shares, netting proceeds of over \$638,000. The average daily trading volume for ABC in the first quarter of 2011 was only about 3,800,000 shares. The large-scale selling of ABC occurred in the RC Account when additional red flags regarding the issuer ("Issuer ABC") were present, as set forth below:

- From 1988 through 2006, Issuer ABC underwent four name changes. Additionally, from 2005 through 2012, Issuer ABC went through three reverse stock splits and one regular stock split.
- Virtually every year that Issuer ABC was required to file reports with the Securities and Exchange Commission ("SEC"), it filed notifications with the SEC indicating that it was unable to file its required financial reports in a timely fashion.

- Issuer ABC issued large quantities of shares to individuals through SEC Form S-8 Registration filings. During 2009 alone, Issuer ABC filed six Form S-8s with the SEC reporting the issuance of over 1,000,000,000 shares of ABC.
- RC was liquidating shares of ABC while stock promotional materials were being disseminated.
- On April 1, 2011, Issuer ABC filed a Form 10-K for the year ending December 31, 2010, with the SEC, noting that the company had an accumulated deficit on its balance sheet of \$16,162,556, and stating that "the Company has suffered recurring losses from operations with a significant accumulated deficit, all of which raise substantial doubt about the Company's ability to continue as a going concern."
- On April 22, 2011, Issuer ABC filed a "Form D" (Notice of Exempt Offering of Securities) with the SEC that was 70 days late, disclosing that, beginning on January 27, 2011, Issuer ABC had been engaged in the offer and sale of unregistered equity shares.

b. Red Flags relating to trading in DEF by the RC Account

During the period from May 24, 2011 through February 29, 2012, the RC Account sold approximately 803,100 common shares of DEF, netting proceeds of approximately \$380,000. The large-scale selling of DEF occurred in the RC Account when additional red flags regarding the issuer (Issuer DEF) were present, as set forth below:

- Issuer DEF was formed through a reverse merger with another entity with a different name on March 2, 2011.
- Issuer DEF had no source of operating revenue, and its balance sheet as of February 28, 2011 indicated that nearly 60% of its total assets consisted of cash.
- Issuer DEF's auditor expressed substantial doubts about Issuer DEF's ability to continue as a going concern as its operations were dependent on obtaining further financing.
- Issuer DEF registered 8,500,000 shares of common stock under a Form S-8 on April 14, 2011 while promotional material regarding DEF was being disseminated.

Frede failed to detect and investigate any of these red flags indicative of potentially suspicious manipulative trading activity and potentially unregistered distributions in the RC Account. During the Relevant Period, Frede failed to detect and conduct appropriate due diligence of these red flags in order to assess the legitimacy of the transactions

including inquiring into the ownership of the securities, the nature of RC's business, how these shares were initially acquired and contemporaneous market activity.

Based on the foregoing, Frede failed to adequately implement the Firm's AML Procedures in violation of FINRA Rules 3310(b) and 2010.

B. I also consent to the imposition of the following sanctions:

1. A four-month suspension from association with any FINRA firm in any principal capacity; and
2. A \$20,000 fine.

The fine shall be due and payable either immediately upon reassociation with a member firm following the four-month suspension noted above, or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding, whichever is earlier.

I specifically and voluntarily waive any right to claim that I am unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

I understand that if I am barred or suspended from associating with any FINRA member in a principal capacity, I become subject to a statutory disqualification as that term is defined in Article III, Section 4 of FINRA's By-Laws, incorporating Section 3(a)(39) of the Securities Exchange Act of 1934. Accordingly, I may not be associated with any FINRA member in a principal capacity, during the period of the bar or suspension (see FINRA Rules 8310 and 8311). Furthermore, because I am subject to a statutory disqualification during the suspension, if I remain associated with a member firm in a non-suspended capacity, an application to continue that association may be required.

II.

WAIVER OF PROCEDURAL RIGHTS

I specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against me;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and

- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, I specifically and voluntarily waive any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

I further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

I understand that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against me; and
- C. If accepted:
 - 1. this AWC will become part of my permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against me;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. I may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. I may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects my: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. I may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. I understand that I may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

I certify that I have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that I have agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce me [the Firm] to submit it.

02/16/2015
Date (mm/dd/yyyy)

Jonathan Harold Frede
Jonathan Harold Frede, Respondent

Accepted by FINRA:

3/2/15
Date

Signed on behalf of the
Director of ODA, by delegated authority

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